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RHEBAAA/DEPT OF ENERGY WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
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RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE

UNCLAS SECTION 01 OF 06 NEW DELHI 000499

SIPDIS

SENSITIVE
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USDOC FOR ITA/MAC/OSA/LDROKER/ASTERN/KRUDD
DEPT OF ENERGY FOR A/S KHARBERT, TCUTLER, CZAMUDA, RLUHAR
DEPT PASS TO USTR CLILIENFELD/AADLER
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA ABAUKOL
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
STATE FOR SCA/INS AND EB/TRA JEFFREY HORWITZ AND TOM ENGLE
USDA PASS FAS/OCRA/RADLER/BEAN/CARVER/RIKER

E.O. 12958: N/A

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SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR THE WEEK OF
FEBRUARY 11 - FEBRUARY 15, 2008

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11. (U) Below is a compilation of Economic highlights from Embassy
New Delhi for the week of February 11-15, 2008.

FURTHER DE-RESERVATION OF
SMALL-SCALE INDUSTRY ITEMS

12. (U) Continuing its steady reform process to increase the
competitiveness of the Indian industry, the Indian Cabinet on
February 8 decided to further prune the list of items reserved for
small-scale production. It announced the "de-reservation" of 79
items, thus leaving only 35 items for exclusive production in the
small scale industry (SSI) sector. The remaining items include food
and allied products, wood and wood products, paper and paper
products, plastic products, organic chemicals, drugs and drug
intermediates, glass and ceramics, mechanical engineering excluding
transport equipment items, and electrical machines and appliances.

13. (U) The de-reservation policy of the GOI aims at increasing the
competitiveness of the Indian small scale industry and promoting job
creation opportunities. While quantitative restrictions were
removed in the 1990s, facilitating liberal imports, the continuation
of reservation prevented domestic large units from producing the
reserved items. This, in essence, has protected SSI units from
internal competition. Critics have also charged that the
reservations discourage small scale businesses from expanding, since
they would lose the targeted benefits. This has acted as a brake on
increasing economies of scale as well as on employment growth.
Despite the recommendations of the 1997 Abid Hussain Committee
Report for immediate complete de-reservation of items (more than 800
items at that time) reserved for small scale production, the GOI
decided to implement the recommendations in a phased manner. The
pace for de-reservation of the items accelerated from 2005 on,
however resulting in the removal of 579 items, a 94% reduction.

¶4. (U) Pepsi won a major legal battle in its fight to operate in Kerala on February 11 when India's Supreme Court ruled in its favor in a case concerning its industrial license. In 2003 the Communist Party of India (Marxist)-controlled Pudukkottai panchayat (village level government) canceled Pepsi's industrial license citing overexploitation of groundwater by the company's Kerala bottling plant. The February 11 Indian Supreme Court decision upheld an earlier Kerala High Court order that quashed the panchayat's cancellation of the license. The Supreme Court ruled that the local governmental body had no jurisdiction to cancel Pepsi's industrial license because it had been obtained in an area notified as an "Integrated Industrial Township."

¶5. (SBU) Coca-Cola and Pepsi both located their Kerala bottling plants in Palakkad district. Pepsi chose to locate itself in an Integrated Industrial Township and Coca-Cola did not. Their differing decisions have had a major impact. Coca-Cola's plant has been shuttered since 2004; Pepsi's production has been unaffected by the hostile panchayat order in large part because it is within the notified industrial area. Coca-Cola has faced fiercer local opposition because of allegations of improper waste disposal and groundwater contamination from its plant. The successful anti-Coke agitation has prompted local leftist groups to step up their opposition to Pepsi as well. After the Kerala High Court quashed the cancellation of Pepsi's license, leftist leaders suggested amending the Industrial Township Area Development Act which provides the basis for establishing notified industrial areas.

¶6. (SBU) COMMENT: Despite the left's demands, the government has not taken any steps to amend the law. This reflects a growing understanding in Kerala that rather than deterring potential investors -- with acts such as amending away the benefits of setting up in notified industrial areas -- the state actually needs to do a

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lot more to attract investment, especially in light of the proactive investment policies of the neighboring South Indian states. END
COMMENT.

JAPAN PULLS OUT OF EASTERN DELHI
FREIGHT CORRIDOR

¶7. (U) An Indian Express article indicated that the Railway Ministry is in a bind to fund the entire Delhi Freight Corridor (DFC) after the Japanese government conveyed that a promised loan be used only for the western route. Originally, the Ministry planned to use an expected 160 billion INR (4 billion USD) loan from Japan to develop links from Delhi to both Mumbai in the west (est. 4.1 billion USD) and Sonagar in the east (est. 2.9 billion USD). Top rail officials said the move was linked to Japanese business interests in the Delhi-Mumbai Industrial Corridor (DMIC). The move also comes amidst Japanese pressure to use electric rather than diesel traction along the Western DFC. Senior officials of Dedicated Freight Corridor Corporation of India Ltd said the loan for the project was being "negotiated at the Railway ministry and they were not in the loop."

DELHI MUMBAI INDUSTRIAL CORRIDOR
DEVELOPMENT CORPORATION (DMICDC)
ISSUES EXPRESSION OF INTEREST

¶8. (U) Abhaya K. Agarwal, DMICDC Director, issued a circular inviting Expressions of Interest (EOI) applications for "1. Preparation of detailed perspective plan for overall DMIC region. 2. Preparation of development plans for various investment nodes with pre feasibility study in DMIC region." The circular states that the GOI envisages the development of the DMIC along the Delhi Mumbai Dedicated Freight Corridor. An advertisement for the EOI ran in the February 9, 2008, Economist.

AIR INDIA AND JET AIRWAYS
NEGOTIATING TO BUY 60 BOEINGS

¶9. (U) The Business standard reported that Boeing is in negotiations with Air India and Jet Airways for 60 wide-bodied aircraft valued at 15 billion USD for international routes. Both airlines already have current deals with Boeing until 2011 and 2012 respectively. The two airlines are currently planning for growth beyond 2011. The executive director of finance for Air India indicated that the orders would be finalized in the next three months while a Jet Airways executive director said a final decision would be made, "...only after looking at the market situation."

COMMERCE MINISTER HEDGES
ON NEW WTO TEXT

¶10. (U) Addressing the press, Commerce Minister Nath welcomed revised WTO draft texts on Agriculture and NAMA released in Geneva on February 8th. Nath stressed that before a final view could be given, the GOI would need to consult with other developing countries and stakeholders. However, the Commerce Minister did share his preliminary views. On agriculture, Nath stated that "significant and effective reduction of trade distorting subsidies of the developed countries is an issue on which there can be no compromise," but was satisfied that the concept of two thirds proportionality in tariff reductions between developed and developing countries was back on the table. On NAMA, Nath said that Indian industry would need more flexibilities and was surprised at the removal of numbers on Para 8. The minister concluded on an optimistic note, stating that the revised text can form the basis for constructive engagement and negotiation in the coming weeks.

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GOI ISSUES TOKEN REFINED OIL PRODUCTS PRICE HIKE

¶11. (SBU) After deferring the issue for months, the Cabinet finally raised petrol (gasoline) and diesel prices, but by a paltry 4% and 3% respectively - the first rise since February 2007 (more septel). According to a Citigroup economist, this price hike is much less than what is required to raise prices to global levels. The price hikes would have needed to be 8% for petrol and 22% for diesel to be proportionate with international trends. Although politically untouchable, prices would also need to be raised 95% and 300% for liquefied petroleum gas (LPG) and kerosene respectively. Citigroup expects the price hike to keep headline inflation trending higher from the Jan 26th 4.11% mark but remaining at below 4.7% levels until the end of the fiscal year.

¶12. (SBU) Because the price hike still does not match international prices, the GOI is expected to issue oil bonds worth Rs 402 billion (about USD 10 billion) to compensate government-owned oil companies for their retail marketing losses versus the Rs 240 billion (USD 6 billion) originally expected. Citi projects that under-recoveries from oil companies will total about Rs 718 billion (USD 18 billion) for FY 2007-08, which ends March 31. As in the past three years, these bonds will likely remain off balance sheet to maintain the deficit target. Comment: The small price hike is the victim of a weak political coalition entering an election year that has been beset by the Left over this issue. Although token, the Left still brayed about it and will be sure to try and make it an issue. The agreement to any hike in this charged atmosphere reflects the strong will of the Prime Minister and the Finance Minister, along with the Minister of Petroleum and Natural Gas, to inject whatever minimal price reforms and expenditure discipline they can. End comment.

UPDATE ON INDIA'S NEW PENSION SCHEME

¶13. (U) D. Swarup, Chairman of the interim Pension Fund Regulatory and Development Authority (PFRDA), while addressing a workshop last week, indicated that the New Pension Scheme (NPS) architecture (which covers new government employees after 2004) would be in place

by the end of May 2008. The PFRDA has already appointed three state-owned pension fund managers - the State Bank of India, the UTI Asset Management Company and Life Insurance Corporation of India. These pension fund managers are expected to start work shortly, perhaps by March 31. The government has not allowed PFRDA to appoint private firms or foreign firms as fund managers. But once the PFRDA bill is passed in Parliament, and if FDI is permitted in the pension sector, US firms could be allowed to be appointed as pension fund managers. PFRDA is currently engaged in the process of registering the NPS trust and appointing a custodian and a trustee bank.

¶14. (U) Until the PFRDA bill is passed in Parliament, the NPS will offer only two investment choices - to invest employees' entire contributions in government securities alone or adopt the investment guidelines applicable to non-government provident funds. For non-government provident funds, the current guidelines limit investments in equities to 10% in private sector debt instruments and/or in equity-linked schemes of mutual funds and 5% in shares of companies that have an investment grade debt rating from at least two credit rating agencies, while 85% must be placed in publicly-owned fixed income instruments. Once the PFRDA Bill is passed by Parliament, the regulator will provide more investment choices such as investing up to 50% of the contributions in equities.

¶15. (SBU) Swarup stated that he expects the PFRDA bill to be passed in Parliament in the forthcoming budget session. Comment: Swarup has not shown this optimism previously, but the bill has been stalled since it was introduced in 2005 and there are low expectations of major legislation being passed in the current environment. It would be a welcome, assertive move by the ruling coalition if the bill

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were to get passed. End comment.

HYDERABAD'S NEW AIRPORT DRAWS
TEST FLIGHTS AND PROTESTS

¶16. (U) Kingfisher and Jet Airways made successful test flights to Hyderabad's new airport in preparation for the facility's March 16 grand opening. Anticipating an opportunity to attract more airlines to operate more routes from the new airport, the government of the South India state of Andhra Pradesh (AP), has cut sales tax on Aviation Turbine Fuel (ATF) from 35 to 4 percent. Several U.S. carriers, reportedly including Continental, U.S. Airways, Delta, and United, are in discussions with the airport about starting direct flights to the United States. HMS Host, a U.S. food-court management firm, will manage the airport's food-and-beverage areas.

¶17. (U) The new airport is not without controversy. Construction of the expressway to the airport is far behind schedule. Several contacts have told Consulate Chennai that they expect that it will take up to two hours to get to the new airport from central Hyderabad. Some of the current airport's employees are not happy about the plans to close the facility when the new airport opens. According to press reports, a group of disgruntled workers staged a sit-in at the current airport, preventing the director from exiting his office for several hours. The workers want the airport to remain open to domestic air traffic, limiting the new airport to international flights. The press also reports that a former Indian Administrative Service officer has filed a public interest lawsuit making the case for the city to have two functioning airports.

PARAMOUNT AIRWAYS EXPANDS
INTO WESTERN INDIA

¶18. (U) Paramount Airways, a regional airline operating in South India, continues its expansion with the acquisition of two Embraer aircraft, raising its fleet size to seven. A company executive told Consulate Chennai that the expansion will allow increased flights on popular routes like Chennai-Hyderabad, as well as expanded service from Bangalore to Goa and Pune, as well as better connections among several cities in the states of Tamil Nadu and Kerala.

BIG BAZAAR EXPANDS OPERATIONS
IN SOUTH INDIA

¶19. (U) National retailer Big Bazaar's South India operations should bring in revenues of USD 250 million in 2008, and the company plans to expand in the region. The company began its South India operations in 2005 with two stores in Bangalore and two in Andhra Pradesh and has seen its annual revenues in the region increase 400 percent since then. The region now accounts for nearly a quarter of the retail chain's income. A top Big Bazaar official told Consulate Chennai that the chain currently operates 23 outlets in South India and plans to add seven more this fiscal year. Big Bazaar generally avoids placing its outlets in the largest metropolitan cities, preferring to operate in the so-called "Tier 2" cities of Andhra Pradesh, Kerala and Tamil Nadu, a strategy that it tends to follow throughout India.

TATAS AND BOEING AGREE
ON DEFENSE JOINT VENTURE

¶20. (U) Boeing and Tata Industries announced a plan to form a joint venture company that will initially include more than 500 million USD of defense related component work. The company is to be established by June 2008. Jim Albaugh, president and CEO of Boeing Integrated Defense Systems said of the joint venture, "It represents another step in our commitment to India," and that it will make,

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"Boeing products more globally competitive." Ratan Tata, Chairman of Tata Industries, stated, "This joint venture between Tata and Boeing is an important part of our strategy to build capabilities in defense and aerospace."

¶21. (U) According to the Hindustan Times, but not announced by the companies, the Tatas will control a majority stake in the joint venture but the total financial investment is still undisclosed. Press releases from Boeing and Tata reveal that in the first phase, Boeing will issue contracts to the new company for work on the F/A-18 Super Hornet, CH-47 Chinook, and P-8 Maritime Patrol Aircraft. The established manufacturing capabilities would then be used as a competitive advantage in future programs such as the Medium Multi-Role Combat Aircraft competition. Aside from manufacturing, the two companies also envisage a research and development center for advanced manufacturing technologies. In related news, last week Boeing also announced that Tata Group would supply components to its 787 Dreamliner program.

AIR INDIA ROUTES
TO U.S. TAKING OFF

¶22. (U) The Indian Express is reporting that Air India will be increasing direct flights to the U.S. The airline just launched a non-stop flight from Delhi to New York last week. Future plans are underway to add Bangalore-San Francisco and stops in Texas and Washington. According to an Air India official the Bangalore-San Francisco route will be important in "connecting the two silicon valleys." For Air India, US-India routes have become the largest revenue earner. Air India and other Indian airlines are looking to grab more of this market, which is predominately serviced by European, Gulf, and Southeast Asian carriers.

INDUSTRY REMAINS ENGAGED
ON COMPETITION LAW

¶23. (U) On February 15, FICCI President Khorakiwala welcomed the Prime Minister to the 80th annual general meeting and made some important remarks about the industry group's engagement on economic reforms. Of note, Khorakiwala pointed out how the new merger and acquisition (M&A) provisions of the competition law are problematic. He criticized the legislation for making it too cumbersome for Indian and US companies to conduct M&A activities. Post's lobbying on this issue on behalf of the USG is having an impact, as the issue

continues to be raised by industry groups at the highest levels in the GOI.

NEW SEBI CHAIRMAN

¶24. (SBU) The Finance Ministry has nominated Chandrasekhar Bhaskar Bhawe, Chairman of the National Securities Depository Limited (NDSL), as the sixth Chairman of the Securities and Exchange Board of India (SEBI), replacing Damodaran who completes his three-year term this week. Bhawe has been involved with the capital markets for many years. He was Senior Executive Director of SEBI under the first Chairman, G.V. Ramakrishna, credited with formulating many initial regulations, as well as conceptualizing the National Stock Exchange. He quit the civil service in the mid-1990s to take up an assignment with the NDSL. There, he revolutionized the capital market by getting market players to accept the new system of dematerialized shares and debentures. NSDL got into a legal battle with SEBI in April 2006 when SEBI uncovered a massive scam involving the cornering of share allotments in IPO's for small investors. It took an intervention from the Securities Appellate Tribunal to settle the matter in NDSL's favor.

¶25. (SBU) As chairman of SEBI, Bhawe is expected to bring to the table his experience in the capital markets and expertise in

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building a stronger securities market infrastructure. He is expected to focus on improving the processes of investigation and enforcement and take stronger measures to create better investor education and institution building. KV Kamath, Chairman of ICICI, told Congenoff that Bhawe is a very good choice; a practical and pragmatic person with regulatory experience. Kamath noted, though, that his first choice would have been Damodaran who he thought had been outstanding. Press reports that Bhawe's appointment has made some brokers and fund managers nervous since he commands respect in the financial sector for both his integrity and professional competence. Bhawe is expected to join as chairman of SEBI on February 17.

¶26. (U) Visit New Delhi's Classified Website:
<http://www.state.sgov/p/sa/newdelhi>

WHITE